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IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

AMERITECH CORPORATION, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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RESPONSE TO CONDITIONAL CROSS-PETITION OF REGIONAL BELL COMPANIES

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QUESTIONS RESTATED

1. Whether the Federal Communications Commission ("FCC") reasonably construed the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, in concluding that "any requesting telecommunications carrier" may obtain access to the incumbent local exchange carriers' ("LECs' ") "unbundled network elements" pursuant to Section 251(c)(3), not merely requesting telecommunications carriers that also have network facilities of their own?

2. Whether the FCC reasonably construed the Act in concluding that when a new entrant purchases access to an incumbent LEC's switch as a "network element," it obtains access to, *inter alia*, the "vertical features" of that switch, given that the Act expressly defines "network element" to include all "features, functions, and capabilities" of the network facility (47 U.S.C. § 3(29))?

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AT&T Corp., ACC Corp., America's Carriers Telecommunications Association, Competitive Telecommunications Association, Excel Telecommunications, Inc., General Communications, Inc., Sprint Corporation, Telecommunications Resellers Association, and WorldCom, Inc., petitioners in this proceeding, respectfully submit this response to the conditional cross-petition filed by the Regional Bell Companies.

The undersigned parties have filed a petition for certiorari which asks the Court to review the Eighth Circuit's decision to invalidate an FCC regulation (47 C.F.R. § 51.315(b)) that is critical to the only form of local exchange competition (unbundled network elements) that can rapidly develop on a broad basis in accord with the objectives of the Telecommunications Act of 1996. In

their conditional cross-petition, the Regional Bell Companies reiterate the same arguments that they previously made in opposition to review by this Court of that holding.[1] They further claim that, if the Court grants review of that holding, it should also review the Eighth Circuit's decision to affirm two other sets of FCC rules: (1) 47 C.F.R. § 51.307(a), which allows any new entrant to obtain from incumbent local exchange carriers ("LECs") unbundled network elements, regardless of whether the new entrant has any facilities of its own, and (2) 47 C.F.R. §§ 51.307(c) and 51.319(c)(1)(C), which allow entrants to use all the features and functionalities of these elements, regardless of whether LECs also choose to offer them as retail services.

As explained below, there is no substance to the Bell Companies' challenge to either of these sets of rules. Each is compelled by the Act's terms, structures, and objectives, and each is, in all events, a reasonable interpretation of those terms and a reasonable means of implementing them. Indeed, the Bell Companies' challenges all constitute attempts to impose extrastatutory limitations on the use of network elements that have no textual or structural basis in the Act, that would serve no conceivable social or competitive object, and that were rejected by the FCC for those reasons.

At the same time, the Eighth Circuit treated the first issue in the Bell Companies' cross-petition as in one sense related to its invalidation of Rule 51.315(b), and the arguments that the Bell Companies make in support of the first issue in the cross-petition are the same arguments that they have made in defending the Eighth Circuit's decision to vacate Rule 51.315(b). In particular, the Eighth Circuit assumed in both contexts that "unbundled" meant "separated," and the Bell Companies' basic claim in both

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[1] *See* Opposition of the Regional Bell Companies to Petitions for a Writ of Certiorari, *AT&T Corp., et al.* v. *Iowa Utilities Board, et al.*, and related cases (Nos. 97-826, 97-829, 97-830, 97-831) (Dec. 18, 1997) at 21-28 ("Bell Companies Opp.").

contexts is that the "statutory distinction" between the use of unbundled network elements and resale, and the historic policy of "universal [telephone] service," would be "obliterated" unless new entrants are prohibited from obtaining and using unbundled network elements in any situation in which those elements would provide capabilities that are similar to LECs' retail services.

Thus, granting certiorari on the first issue in the cross-petition would entail no, or little, incremental work on the part of the Court. Indeed, even if it were not granted, the undersigned parties, in addressing Rule 51.315(b), would also likely refer to the rules and the portion of the *First Report and Order* that the first part of that cross-petition challenges. Accordingly, although the second issue (on "vertical features") does not bear the same connection to these other issues and is not certworthy, the undersigned parties do not oppose the cross-petition on the first issue it raises. In all events, the lack of merit in the Bell Companies' challenges to these rules underscores the importance of review of the Eighth Circuit's decision to invalidate Rule 51.315(b).

STATEMENT OF THE CASE

1. The landmark Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, was enacted to "shift monopoly [local telephone] markets to competition as quickly as possible."[2] As previously described,[3] it therefore authorizes three modes of entry that allow new entrants to use essential facilities and services that are controlled by the incumbent local monopolists.

The narrowest and least significant of these is the "resale" of LEC services that is authorized by Section 251(c)(4). It allows new entrants to obtain the LECs'

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[2] H.R. Rep. No. 104-204 at 89 (1995); *see also* Joint Explanatory Statement of the Comm. of Conference, H.R. Rep. No. 104-458 at 113 (1996); S. Rep. No. 104-23 at 1 (1995).

[3] *See* AT&T Pet. 1-8; MCI Pet. 1-6; U.S. Pet. 2-5.

existing *retail* exchange services at wholesale rates (computed by subtracting from the LECs' retail rates the costs that they avoid when services are provided only at wholesale), and then only to "resell" those same services in competition with the LECs. Section 251(c)(4) thus allows entry into only *part* of the local telephone market, for resale cannot be used to offer the "exchange access" services that are provided at wholesale to long-distance carriers to originate and terminate long-distance calls (which represent over 20% of the LECs' over $100 billion in local telephone revenues), or to offer any service that the LECs choose not to offer. See Pet. App. 245a; see also AT&T Pet. 4, 27; U.S. Pet. 3-5.

In addition to resale, however, Section 251 establishes two other modes of entry that allow new entrants to enter the *entire* local telephone market and to compete with the full range of services that the LECs offer. Section 251(c)(2) allows a firm that has connected some individual customers to its own alternative local exchange facilities to interconnect with the LEC's network at cost-based rates. That will enable that firm's customers to place calls to, and receive calls from, the incumbent LEC's customers. But because the time and expense of constructing redundant facilities is so great, this mode of entry could not lead to broad-based competition for years or decades.

Most pertinently for present purposes, Section 251(c)(3) requires LECs to provide access at nondiscriminatory and cost-based rates to any or all of the individual components of the local exchange network that the Act defines to be "network elements." Section 3(29) of the Act provides that a carrier purchasing access to a network facility or piece of network equipment as a "network element" is entitled to all "features, functions and capabilities that are provided by means of such facility or equipment." Cross-Resp. App. 1a.[4] By authorizing

[4] References to "Cross-Resp. App." are to the appendix to this response. We have included in that appendix only those portions

new entrants to obtain access to individual network elements with all their features and at their costs, Congress intended to allow new entrants to share in whatever economies of scale inhere in particular LEC facilities and thus to use those facilities to provide any and all local services on a broad basis. Unlike resale, a carrier that obtains access to network elements is not limited to mimicking the LEC's retail services, but may compete by offering the full range of services that those elements are capable of providing, including exchange access services as well as new and innovative services that the LEC may have chosen not to offer.

2. Contrary to the suggestion made by the Bell Companies (Cross-Pet. 6-8), the Act's establishment of different pricing mechanisms for resale and unbundled network elements has nothing to do with the preservation of "universal service"—the assurance of affordable telephone service to all persons. It is true that the LECs have long claimed that they price their residential services below the cost of providing those services, and that they need to charge rates to business customers substantially in excess of cost in order to subsidize those residential rates. Those claims, however, have been shown by the LECs themselves to be inflated and baseless.[5]

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of the Act and the *First Report and Order* that are cited in this response and that have not previously been included in any of the filed appendices. References to "Pet. App." are to the appendix filed in No. 97-826 and used by all petitioners. References to "Cross-Pet. App." are to the appendix filed by the Regional Bell Companies with their conditional cross-petition.

[5] For example, sworn testimony provided by U S WEST has demonstrated that, although U S WEST's tariffed monthly rate for residential exchange service, standing alone, may be less than its costs of providing that service, its *revenues* from providing that service far exceed its cost—with a profit margin of about 59%. That is because, over and above the tariffed monthly rate for local exchange service, U S WEST (and all LECs) obtain substantial additional revenues for each residential customer, including (1) revenues

In all events, the 1996 Telecommunications Act rendered any such claims moot. Section 254 of the Act—entitled "Universal Service"—invalidates the system of inter-service subsidies that the cross-petition repeatedly invokes. *See* Cross-Resp. App. 1a-9a. Although the Bell Companies do not even cite Section 254 in their cross-petition, that provision establishes a wholly new mechanism for funding universal service that does not depend on implicit subsidies from excessive rates charged to certain classes of customers. Instead, Section 254 adopts a new system in which universal service is not to be financed from rates that LECs charge competitors, but rather from a separate fund to which all providers of service—*including* new entrants that provide service through the LECs' unbundled network elements—will contribute proportionately and on a competitively neutral basis.

As the FCC has explained, Section 254 of the Act mandates "reform" of the pre-existing "patchwork quilt of implicit and explicit subsidies" that, in the name of "universal service," "deter[] . . . competition." Pet. App. 133a-134a. Indeed, the FCC has observed that such reform is "vitally connected" to its local competition rules: "The present universal service system is incompatible with the statutory mandate to introduce efficient competition into local markets, because the current system distorts competition in those markets." *Id.* at 134a-135a. The FCC therefore stated in its local competition rulemaking

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from exchange access for long distance calls to and from that customer, (2) revenues from "vertical features" like Caller ID, Call Waiting, and Call Forwarding, (3) revenues from the "subscriber line charge" that the customer pays the LEC each month, and (4) revenues from toll calls the customer makes within the LEC's area of service. *See* Direct Testimony of Frank Hatzenbuehler, U S WEST Communications, Inc., *In re The Investigation and Suspension of Tariff Sheets Filed by U S WEST Communications, Inc. with Advice Letter No. 2617 Regarding Tariffs for Interconnection, Local Termination, Unbundling, and Resale of Services*, Colorado Public Utilities Commission Docket No. 96S-331T (Dec. 13, 1996).

that it would, in a separate proceeding, "rework the subsidy system" pursuant to the mandate of Section 254 so as to "ensure that the goals of affordable service and access to advanced services are met by means that enhance, rather than distort, competition." *Id.* at 135a. The FCC subsequently issued its universal service order.[6]

There is thus no possibility that the local competition provisions of the 1996 Act could undermine universal service. Both incumbent LECs and the new entrants that purchase unbundled network elements at cost-based rates will proportionately incur the same network costs and the same universal service contribution costs. Moreover, no rates that are currently "below-cost" will increase, because any such rates will continue to be subsidized—but under the mechanism established by Section 254 instead of through the prior regime. However, insofar as the LECs have been charging other customers rates that exceed their network costs (including a reasonable profit) *plus* any necessary contribution to universal service—and their rates in many instances greatly exceed that amount—competition through network elements will drive those rates downward. That outcome of lower rates, which the LECs here resist, is one of the central benefits Congress sought to achieve by introducing competition into these markets.

Congress' purpose in establishing multiple modes of entry was therefore not to preserve a "universal service" regime that the Act elsewhere invalidates, but rather to create a range of choices and opportunities for new entrants with different business plans and capabilities. In that regard, although resale alone cannot enable new entrants to offer immediate and broad-based competition to the LECs, and cannot create any competition at all in exchange access services, there are other situations in which resale can play an important role. For example,

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[6] *See* Report and Order, *Federal-State Joint Board on Universal Service*, 12 FCC Rcd. 8776 (released May 8, 1997) (*"Universal Service Order"*).

because new entrants providing service through resale will be able to provide fewer services than carriers purchasing network elements, and will merely be passing on the LECs' existing retail services to their own customers, resale is an easier mode of entry for a new entrant to execute and requires the development of fewer internal business systems by the new entrant. As a result, resale allows faster initial entry. Indeed, even before the Eighth Circuit's decision, the small amount of local competition that had been generated in the initial stages since passage of the 1996 Act was overwhelmingly through resale, not network elements. Additionally, resale enables some limited competitive services to be provided to any customers who are currently served by the LECs at subsidized rates, or who for other reasons cannot otherwise be served economically by competitive carriers. See *infra* pp. 17-18.

3. In the *First Report and Order*, the FCC adopted rules implementing the "network element" requirements of Section 251(c)(3) as well as other new requirements of Section 251. Of pertinence here, the FCC addressed the two issues that the Bell Companies raise in their cross-petition. To begin with, the LECs had argued that the FCC should adopt a rule limiting the availability of network elements only to those new entrants that already possess some unspecified number of network facilities of their own. The LECs contended that, if a new entrant could purchase all the network elements needed to provide a competing service without having facilities of its own, it would be purchasing the equivalent of a service for resale, and that permitting such access would render Section 251(c)(4)'s resale requirement "meaningless." Pet. App. 237a.

The FCC rejected this argument on several independent grounds. First, it concluded that such a rule found no support in the statutory language. To the contrary, "[t]he language of Section 251(c)(3) . . . does not discuss, reference, or suggest [such] a limitation or requirement in

connection with the right of new entrants to obtain access to unbundled elements." Pet. App. 242a.

Second, the FCC rejected the factual premise of the LECs' argument. It held that providing service exclusively through a combination of network elements was not the equivalent of resale. To the contrary, it found that the two entry vehicles "present different opportunities, risks, and costs in connection with entry into local telephone markets, and that these differences will influence the entry strategies of potential competitors." Pet. App. 244a. Thus, no "limitation on the ability of carriers to enter local markets under the terms of section 251(c)(3)" is necessary "in order to ensure that section 251(c)(4) retains functional validity as a means to enter local phone markets." *Id.*

Third, the FCC found that it would be "administratively impossible" to impose the limitation the LECs sought, for there was no statutory or other basis through which to define how much, and which, facilities a new entrant would have to possess in order to avail itself of the right to purchase network elements. Any such requirement would thus be inherently arbitrary, and would either be so easy to meet as to be "meaningless," or would "creat[e] incentives [for new entrants] to build inefficient network architectures that respond not to marketplace factors, but to regulation." Pet. App. 248a.

In a separate section of the *First Report and Order*, the FCC also defined the specific network elements that incumbent LECs would be required to provide under Section 251(c)(3). There was virtually no dispute that "local switching" is an unbundled network element. See Cross-Resp. App. 10a-11a. The switch contains much of the software that is used to route calls, to provide special features to customers, and to perform other network functions. The LECs maintained, however, that even if new entrants purchasing access to the switch under Section 251(c)(3)

were given access to the switch software that routes calls for basic local calling, they should not be granted access to "vertical features" in the switch, which the incumbent LECs use to provide Caller ID, Call Waiting, and Call Forwarding.

Instead, the LECs maintained that new entrants should only be able to provide such functions through resale under Section 251(c)(4). The import of this claim was clear. The cost of these vertical features is a tiny fraction of the rates the LECs charge their customers, so the LECs currently earn enormous margins on them. The resale pricing standard would preserve those margins, for it would require that new entrants purchase vertical features at the existing retail rate, minus only the costs the LECs could avoid by selling them at wholesale rather than at retail, and would thus render it impossible for new entrants to compete those prices down.

The FCC rejected this contention as flatly inconsistent with the plain language and purpose of the Act. Section 3(29) of the Act defines network element as "a facility or equipment used in the provision of a telecommunications service," and expressly provides that "[s]uch term also includes features, functions, and capabilities that are provided by means of such facility or equipment." Cross-Resp. App. 1a. The FCC found that "[v]ertical switching features, such as call waiting, are provided through operation of hardware and software comprising the 'facility' that is the switch, and thus are 'features' and 'functions' of the switch." Cross-Pet. App. 12a; see also Cross-Resp. App. 12a. The FCC further observed that if it were to conclude, as the LECs urged, that "any functionality sold directly to end users as a service, such as call forwarding or caller ID, cannot be defined as a network element," then incumbent LECs could "entirely evade the unbundling requirement in section 251(c)(3)" by choosing to market network elements as "services" to end users. Cross-Resp. App. 10a. Moreover, it found that adopting

such a proposition would substantially undermine "the procompetitive objectives of the 1996 Act." *Id.* at 12a.

4. The LECs unsuccessfully challenged both of these holdings before the Eighth Circuit. First, the Eighth Circuit rejected the LECs' contention that the FCC should have engrafted a limitation on Section 251(c)(3) so that only carriers with facilities of their own could purchase network elements. It held that the "plain language of subsection 251(c)(3) indicates that a requesting carrier may achieve the capability to provide telecommunications services completely through access to the unbundled elements of an incumbent LECs' network." Pet. App. 55a. As the court of appeals explained, "[n]othing in this subsection requires a competing carrier to own or control some portion of a telecommunications network before being able to purchase unbundled elements. To the contrary, this subsection imposes a duty on incumbent LECs to provide unbundled access 'to *any* requesting telecommunications carrier for the provision of a telecommunications service.' 47 U.S.C. 251(c)(3)." *Id.* (emphasis added by court of appeals).

The court of appeals then went on to address the LECs' argument that the widespread availability of network elements would nullify the Act's provision on resale. It stated that it did not "believe" that all requesting carriers would select network elements over resale as an entry vehicle, because "unbundled access has several disadvantages that preserve resale as a meaningful alternative." *Id.* at 56a. The court of appeals noted that carriers purchasing unbundled network elements "face greater risks than those carriers that resell an incumbent LEC's services" because, unlike resellers, a carrier purchasing network elements must make an investment "without knowing whether consumer demand will be sufficient to cover such expenditures." *Id.* The court of appeals also stated that "our decision requiring the requesting carriers to combine the elements themselves increases the costs and

risks associated with unbundled access as a method of entering the local telecommunications industry and simultaneously makes resale a distinct and attractive option." *Id.* at 56a-57a.

The Eighth Circuit also upheld the FCC's determination on vertical features. It noted that Caller ID, Call Waiting, and similar capabilities "are provided through the switching hardware and software that are also used to transmit calls across phone lines," and thus are plainly encompassed within the Act's definition of "network elements." *Id.* at 44a. It rejected the LECs' contention that "[s]imply because these capabilities can be labeled as 'services' " they could not be subject to Section 251(c)(3), and agreed with the FCC that accepting such an argument "would allow the incumbent LECs to evade a substantial portion of their unbundling obligation." *Id.* at 44a-45a.

ARGUMENT

The two claims made in the Bell Companies' cross-petition were properly rejected by both the FCC and the court of appeals. Neither of those claims has any basis in the statute's text or structure. To the contrary, each would add severe extrastatutory limitations to statutory obligations that Congress could not have written in more broad and unqualified terms. Further, each would patently undermine the pro-competitive objective of the 1996 Act, for the sole purpose and effect would be to constrict sharply the only entry vehicle—unbundled network elements—that can provide the rapid and broad-based competition that Congress sought to foster.

Indeed, the only rationale the Bell Companies offer for their limitations is a spurious policy argument. The Bell Companies claim that Congress must have intended those limitations because they are somehow necessary to preserve the preexisting universal service regime. But that is the regime that Section 254 of the Act invalidates and re-

places. That is also the regime whose continuation, the FCC found, would distort competition and deter competitive entry, contrary to the Act's central goals.

At the same time, although the issues the Bell Companies raise are not independently certworthy, the first claim in the cross-petition does bear some relationship to the most important question presented by the United States and the undersigned petitioners: the Eighth Circuit's invalidation of Rule 51.315(b). For example, the court of appeals addressed its interpretation of the statutory term "unbundled" both in the course of invalidating Rule 51.315(b) and in the course of rejecting the LECs' claim that the FCC should have limited the purchase of unbundled network elements to carriers that own their own facilities. Further, the Bell Companies make the same arguments in challenging that aspect of the Eighth Circuit's decision as they apparently would make in defending the Eighth Circuit's invalidation of Rule 51.315(b). Both sides in this case would therefore be likely to refer to the aspects of the *First Report and Order* challenged in the first question in that cross-petition even if they were only addressing the reasonableness of Rule 51.315(b). Accordingly, because it would enable the Court to have before it all issues that are potentially related while not adding substantially to the scope of the case, the undersigned parties do not oppose granting the Bell Companies' cross-petition on its first issue.

1. The Bell Companies claim that the FCC should have restricted the availability of network elements solely to carriers that own some of their own facilities. This claim is based on the contention that such a restriction is necessary in order to prevent alleged "regulatory arbitrage" that would undermine universal service. Cross-Pet. 21. The Bell Companies claim that the availability of network elements at cost-based rates would enable new entrants to avoid paying the universal service contribu-

tions that the Bell Companies claim are embedded in their above-cost retail rates (the rates on which the wholesale discount for resold services is likewise based).[7]

However, even if this policy argument were otherwise valid, it could not support the limitation on network element competition that the Bell Companies seek. Indeed, it bears no relationship whatsoever to that limitation. Even under the Bell Companies' view, competitors that do own some facilities and purchase access to other network elements from the LECs could achieve precisely the result, although on a smaller scale, that the Bell Companies say they fear, because those competitors could likewise compete with the LECs' high-priced services at cost-based rates. This underscores that the Bell Companies' real quarrel is not with the FCC's straightforward application of Section 251(c)(3), but with the Act's requirement of cost-based rates.

In all events, the Bell Companies' policy argument is *not* otherwise valid. It is the same generic claim that has been made by the incumbent monopolist, and disproved, every time competition has been introduced into a monopoly segment of the telecommunications industry.[8] Here,

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[7] In that regard, the Bell Companies' claims that the resolution of these issues threatens to "obliterate" a "crucial statutory distinction," jeopardize universal service, and open the door to "regulatory arbitrage" (Cross-Pet. 2, 6-8, 21-22), however meritless, are difficult to square with their previous disingenuous assertions that these are merely "second level" "tag along" matters of no importance, unworthy of further review. Regional Bell Company Opp. 2, 21. Their cross-petition confirms the certworthiness of the Eighth Circuit's invalidation of Rule 51.315(b).

[8] For example, the former Bell System likewise repeatedly contended that competition in the long-distance industry would destroy the subsidies that support universal service. *See, e.g.*, "An Unusual Obligation," Address by John DeButts, Chairman of the Board of AT&T, to NARUC Annual Convention (Sept. 30, 1973), quoted in full in *Southern Pacific Communications Co.* v. *American Telephone & Telegraph Co.*, 556 F. Supp. 825, 894-902 (D.D.C. 1983).

the claim is especially inapt, for Section 254 of the Act invalidates the system of inter-service subsidies that the Bell Companies claim their extrastatutory limitations on network element competition are needed to perpetuate.

Specifically, under the new system for funding universal service, implicit subsidies must be eliminated and universal service must instead be financed through a new, separate and explicit fund to which both LECs and purchasers of network elements must contribute. New entrants purchasing network elements will therefore incur the same proportionate expenses of funding universal service as incumbent LECs, and any below-cost rates will continue to have a source of subsidy. At the same time, new entrants will be able to compete with the LECs without paying the LECs a charge based on the supracompetitive rates that the LECs currently charge some retail customers—rates that far exceed the sum of network costs and actual universal service contributions. Thus, these entrants will be able to place substantial downward pressure on those excessive rates that cannot harm universal service, but that will help achieve the precise competitive benefits the Act was enacted to create: lower, competitive prices for consumers.

Nor do the Bell Companies have any legitimate complaint about the timing of Section 254's implementation. To be sure, while the local competition provisions of the Act took effect immediately, the FCC's *Universal Service Order* did not immediately establish and implement all elements of the system, but maintained the existing support mechanisms for an interim period. In particular, some of those mechanisms will be maintained until January 1, 1999, at which time providers of interstate services will begin making the competitively neutral universal service payments contemplated by Section 254. Similarly, while States are permitted to require all carriers to make interim or permanent payments based on their revenues from intrastate services, that Order does not compel the States to establish any particular schedule.

But this short gap in timing has no legal or practical significance. The Act requires that the local competition provisions of Sections 251 and 252 take effect before Section 254. Compare Section 251(d)(1) with Section 254(a). That is presumably because Congress recognized, as the FCC subsequently has found, that there is no prospect of such a massive growth of local competition during that short interim period as would place any pressure on universal service. See Order, *Access Charge Reform*, 12 FCC Rcd. 10175, 10184 (released June 18, 1997). Further, the FCC and the States could provide adequate interim remedies in the unlikely event that prediction proved incorrect. By contrast, the Bell Companies' proposed distortions of the statute are not limited to that short interim period and would not be eliminated even once Section 254 were fully implemented, but would continue indefinitely to erect an immense barrier to the development of competition.

Accordingly, the Bell Companies policy argument is completely unfounded and cannot support their claims. And once that argument is set aside, the Bell Companies have nothing left to say in defense of their reading of the Act. They make no serious attempt even to address the several independent grounds on which the FCC declined to add to Section 251(c)(3) the severe restriction they propose. None of those grounds is at all arbitrary or contrary to law.

First, as the FCC found (Pet. App. 242a), the plain language of the Act forecloses the Bell Companies' claim. Section 251(c)(3) requires LECs to provide network elements to "*any* requesting telecommunications carrier," not just to carriers that control their own facilities. Section 3(44) of the Act defines "telecommunications carrier" as "any provider of telecommunications services" (Cross-Resp. App. 1a), and Section 3(46) in turn defines "telecommunications services" as "the offering of telecommunications for a fee directly to the public . . . *regardless*

of the facilities used." Cross-Resp. App. 1a (emphasis added). The right to purchase unbundled elements thus expressly extends to all competitors regardless of whether they provide service through their own facilities or the LEC's facilities.

The Bell Companies ignore this holding. Their sole textual argument is their claim (Cross-Pet. 18) that Section 251(c)(3)'s requirement that they provide "access" to network elements "at any technically feasible point" means that new entrants must have some of their own facilities to connect to the LECs' network elements. However, as the FCC held (Pet. App. 242a-243a), this claim confuses "access" to network elements under Section 251 (c)(3) with the "interconnection" of facilities under Section 251(c)(2), for access does not require physical interconnection. In all events, this claim is irrelevant, for new entrants that provide service exclusively through network elements do in fact physically interconnect with those network elements through the incumbent LECs' operations support system. See *First Report and Order*, ¶ 516-528; Petitioners' Lodging, Volume I at 252-257.

Second, the Bell Companies' argument is based on the false premise that additional limitations must be placed on competition through network elements in order to prevent the Act's resale provisions from being nullified through lack of use. But Congress did not think that such limitations were necessary in order to preserve the utility of resale, and with good reason. There are several contexts in which new entrants will find resale the most appropriate entry vehicle—such as where particularly fast or easy entry into a market is desired, where a new entrant's business plan only involves providing a small range of services, where a new entrant can offer customers lower rates by aggregating multiple customer volumes onto a LEC volume discount plan, or where customers may be

being served by the incumbent LEC at subsidized rates.[9] Indeed, even before the Eighth Circuit invalidated Rule 51.315(b), while the competitive exchange services that were being offered were small in scope (as they still are), the overwhelming majority of them were being offered through resale.

Further, the FCC found, on the basis of a voluminous record, that unbundled network elements naturally present a new entrant with both greater competitive opportunities and greater competitive risks, and that there was no prospect that the availability of combined network elements would nullify the provisions requiring that services also be made available for resale or would render those provisions unlikely to be used. Pet. App. 243a-246a. For example, while the purchaser of network elements has the opportunity to provide a broader range of competitive services and to innovate so as to differentiate its services from the LEC's, it also runs the risk—unlike a reseller—that there will be insufficient customer demand for it to recoup its costs. *Id.*[10] The Bell Companies have not even

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[9] Contrary to the Bell Companies' suggestion (Cross-Pet. 21-22), there is nothing illegitimate about using resale to provide service to the customers who they claim are charged "below-cost" rates. Indeed, the snippet of legislative history the Bell Companies cite (from a substantially earlier and different version of the bill) expressly contemplated that the resale rate would and should reflect the degree to which the retail rate is "subsidized." *See* Cross-Pet. 8 (quoting House Report at 72). The FCC's *Universal Service Order* (12 FCC Rcd. 8776, 8866 (May 8, 1997)) provides that in such instances the incumbent LEC, not the reseller, still receives the universal service subsidy from the fund established under Section 254, so the LEC is placed at no economic advantage.

[10] That is what the AT&T executive stated in the remarks grossly mischaracterized by the cross-petition (Cross-Pet. 14-15). He did not suggest, as the Bell Companies claim, that new entrants could get the "equivalent" of resale at twice the discount by purchasing network elements. To the contrary, he stated that AT&T's "cost of goods sold" by purchasing network elements is "slightly *above*" the cost of purchasing services for resale, but that, *assuming* long distance usage by the customer of at least $25 a

attempted to show, and cannot show, that the FCC's factual findings on this issue did not rest on substantial evidence.

Third, the FCC also found that the Bell Companies' proposed restriction could not rationally be administered. If the FCC simply required new entrants to own some facility, no matter how trivial in size or scope, the requirement would be "so easy to meet it would ultimately be meaningless." Pet. App. 248a. On the other hand, if the FCC required a specific level of investment in particular facilities, the statute would provide no guidance on what that level should be. And any such requirement would have the additional adverse effect of "creating incentives to build inefficient network architectures." *Id.* The Bell Companies do not attempt to refute, much less acknowledge, this ground for the FCC's decision.

The Bell Companies thus have no plausible argument that the FCC and the Eighth Circuit erred in rejecting their claim. However, this claim is related in at least one sense to the claim of the United States and the undersigned petitioners that the Eighth Circuit erred in invalidating Rule 51.315(b) as inconsistent with the requirement of "unbundled" access, because in the course of rejecting the LECs' claim that unbundled network elements should be limited to carriers with their own facilities, the Eighth Circuit also discussed its understanding of the term "unbundled." Pet. App. 56a-57a. While the Bell Companies substantially overstate their case in contending that this discussion was "crucial" to the Eighth Circuit's

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month, that added cost could be offset by revenues that AT&T could obtain through providing exchange access services. In other words, he noted that by assuming a certain risk that resellers do not assume, and incurring additional cost, AT&T might reap greater rewards through purchasing network elements than through resale—precisely the point made by the FCC. *See* Transcript, AT&T Investment Community Meeting (March 3, 1997).

rejection of their claim,[11] it is clear that they would make the same overall argument in support of the Eighth Circuit's invalidation of Rule 51.315(b) as they make in arguing this claim in their cross-petition, and that the Court could thus efficiently address them both together. On that basis, petitioners do not oppose this cross-petition.

2. Unlike its discussion of the cross-petition's first question, the Eighth Circuit's discussion of "vertical features" did not address any aspect of its reasoning in invalidating Rule 51.315(b). Pet. App. 44a-45a. The Bell Companies nonetheless argue (Cross-Pet. 22) that the two are linked by common themes. However, on this issue the Eighth Circuit simply applied the statutory definition of "network element," as had the FCC.

Specifically, special features such as Caller ID and Call Waiting are provided to customers through the operation of hardware and software that generally reside within the LECs' switches, just as basic calling capabilities, such as the routing of a typical "plain vanilla" local call, are likewise provided through such switch hardware and software. No one seriously disputes that the switch facility is a network element, and the statutory definition of network element expressly stated that an element "includes" all "features, functions and capabilities" of the pertinent facility. See 47 U.S.C. 3(29); Cross-Pet. App. 1a. There is no material difference in this respect between the switch features, functions, and capabilities that are used to provide dialtone and call routing, for example, and the switch features, functions, and capabilities that are used to provide Caller ID, Call Waiting, and Call Forwarding—and

[11] The Eighth Circuit's holding that the FCC's determination was proper could not and did not rest on its separate decision that "unbundled" meant "separated." The court of appeals could only uphold the FCC's decision on the grounds on which the FCC relied, *see SEC* v. *Chenery Corp.*, 318 U.S. 80, 87-88 (1943), and the FCC had adopted a contrary definition of "unbundled." The Eighth Circuit's *holding* was thus its statement that "the FCC's determination . . . is reasonable." Pet. App. 55a.

certainly no legal basis to exclude either when the switch is provided as a "network element." All are "features," "functions," and "capabilities" of the switch.[12]

The Bell Companies (Cross-Pet. 24) contend that vertical features cannot be part of the switching element because a network element is defined as a facility "used" in the provision of telecommunications services, while Caller ID, Call Waiting, and Call Forwarding purportedly are not "used" to provide services but are "themselves" services. This is semantic sleight of hand. The new entrant purchasing access to the switch is purchasing access to the software and hardware features of the switch, which it will then use to provide both basic calling capabilities and special features to its customers. That is precisely what the statutory definition of network element authorizes.

Finally, the Bell Companies' contention that they should be permitted to exclude vertical features from the network element they provide new entrants simply because vertical features can be characterized (like the rest of their network) as being used to provide retail services vividly confirms that the FCC and the Eighth Circuit were correct in concluding that the holding that the Bell Companies seek would improperly permit incumbent LECs to "evade" the network element requirements of the Act by marketing network elements, or portions thereof, to end users as services. Pet. App. 44a-45a.

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[12] The Bell Companies state (Cross-Pet. 23) that the FCC determined that vertical features were themselves "network elements." That is incorrect. The FCC "decline[d]" to require "unbundling of the local switch into a basic switching element and independent vertical feature elements." Cross-Resp. App. 11a-12a. Instead, it held that such features are *part* of the switching element. Cross-Pet. App. 11a.

CONCLUSION

Although the claims raised in the cross-petition are substantively meritless and not independently certworthy, the Bell Companies are making many of the same arguments on the first issue that they apparently will make in defending the Eighth Circuit's invalidation of Rule 51.315(b), and the Eighth Circuit treated those issues to some degree as interrelated. In light of that, the undersigned petitioners do not oppose a grant of the cross-petition on that issue if our own petition is granted. By contrast, the second issue in the cross-petition bears no relationship to the issue raised by the petition, and reflects instead the application of a separate provision of the Act in a manner that was compelled by its plain terms. Certiorari on that question should be denied.

Respectfully submitted,

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APPENDICES

APPENDIX A

47 U.S.C. § 3(29) Network element.—The term "network element" means a facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment, including subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing, or other provision of a telecommunications service.

* * * *

47 U.S.C. § 3(44) Telecommunications carrier.—The term "telecommunications carrier" means any provider of telecommunications services, except that such term does not include aggregators of telecommunications services (as defined in Section 226). A telecommunications carrier shall be treated as a common carrier under this Act only to the extent that it is engaged in providing telecommunications services, except that the Commission shall determine whether the provision of fixed and mobile satellite service shall be treated as common carriage.

* * * *

47 U.S.C. § 3(46) Telecommunications service.—The term "telecommunications service" means the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.

* * * *

47 U.S.C. § 254 Universal Service.—(a) Procedures to Review Universal Service Requirements.—

(1) Federal-state joint board on universal service.—Within one month after the date of enactment of the Telecommunications Act of 1996, the Commission shall institute and refer to a Federal-State Joint Board under Section 410(c) a proceeding to recommend changes to any

of its regulations in order to implement Section 214(e) and this section, including the definition of the services that are supported by Federal universal service support mechanisms and a specific timetable for completion of such recommendations. In addition to the members of the Joint Board required under Section 410(c), one member of such Joint Board shall be a State-appointed utility consumer advocate nominated by a national organization of State utility consumer advocates. The Joint Board shall, after notice and opportunity for public comment, make its recommendations to the Commission 9 months after the date of enactment of the Telecommunications Act of 1996.

(2) Commission action.—The Commission shall initiate a single proceeding to implement the recommendations from the Joint Board required by paragraph (1) and shall complete such proceeding within 15 months after the date of enactment of the Telecommunications Act of 1996. The rules established by such proceeding shall include a definition of the services that are supported by Federal universal service support mechanisms and a specific timetable for implementation. Thereafter, the Commission shall complete any proceeding to implement subsequent recommendations from any Joint Board on universal service within one year after receiving such recommendations.

(b) Universal Service Principles.—The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles:

(1) Quality and rates.—Quality services should be available at just, reasonable, and affordable rates.

(2) Access to advanced services.—Access to advanced telecommunications and information services should be provided in all regions of the Nation.

(3) Access in rural and high cost areas.—Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

(4) Equitable and nondiscriminatory contributions.—All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.

(5) Specific and predictable support mechanisms.—There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.

(6) Access to advanced telecommunications services for schools, health care, and libraries.—Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in subsection (h).

(7) Additional principles.—Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.

(c) Definition.—(1) In general.—Universal service is an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services. The Joint Board in recommending, and the Commission in establishing, the definition of the services that are supported by Federal universal service support mechanisms shall consider the extent to which such telecommunications services—

(A) are essential to education, public health, or public safety;

(B) have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers;

(C) are being deployed in public telecommunications networks by telecommunications carriers; and

(D) are consistent with the public interest, convenience, and necessity.

(2) Alterations and modifications.—The Joint Board may, from time to time, recommend to the Commission modifications in the definition of the services that are supported by Federal universal service support mechanisms.

(3) Special services.—In addition to the services included in the definition of universal service under paragraph (1), the Commission may designate additional services for such support mechanisms for schools, libraries, and health care providers for the purposes of subsection (h).

(d) Telecommunications Carrier Contribution.—Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service. The Commission may exempt a carrier or class of carriers from this requirement if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution to the preservation and advancement of universal service would be de minimis. Any other provider of interstate telecommunications may be required to contribute to the preservation and advancement of universal service if the public interest so requires.

(e) Universal Service Support.—After the date on which Commission regulations implementing this section

take effect, only an eligible telecommunications carrier designated under Section 214(e) shall be eligible to receive specific Federal universal service support. A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. Any such support should be explicit and sufficient to achieve the purposes of this section.

(f) State Authority.—A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

(g) Interexchange and Interstate Services.—Within 6 months after the date of enactment of the Telecommunications Act of 1996, the Commission shall adopt rules to require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other State.

(h) Telecommunications Services for Certain Providers.—

(1) In general.—

(A) Health care providers for rural areas.—A telecommunications carrier shall, upon receiving a bona fide request, provide telecommunications services which are necessary for the provision of health care services in a State, including instruction relating to such services, to any public or nonprofit health care provider that serves persons who reside in rural areas in that State at rates that are reasonably comparable to rates charged for similar services in urban areas in that State. A telecommunications carrier providing service under this paragraph shall be entitled to have an amount equal to the difference, if any, between the rates for services provided to health care providers for rural areas in a State and the rates for similar services provided to other customers in comparable rural areas in that State treated as a service obligation as a part of its obligation to participate in the mechanisms to preserve and advance universal service.

(B) Educational providers and libraries.—All telecommunications carriers serving a geographic area shall, upon a bona fide request for any of its services that are within the definition of universal service under subsection (c)(3), provide such services to elementary schools, secondary schools, and libraries for educational purposes at rates less than the amounts charged for similar services to other parties. The discount shall be an amount that the Commission, with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary to ensure affordable access to and use of such services by such entities. A telecommunications carrier providing service under this paragraph shall—

(i) have an amount equal to the amount of the discount treated as an offset to its obligation to contribute to the mechanisms to preserve and advance universal service, or

(ii) notwithstanding the provisions of subsection (e) of this section, receive reimbursement utilizing the support mechanisms to preserve and advance universal service.

(2) Advanced services.—The Commission shall establish competitively neutral rules—

(A) to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and nonprofit elementary and secondary school classrooms, health care providers, and libraries; and

(B) to define the circumstances under which a telecommunications carrier may be required to connect its network to such public institutional telecommunications users.

(3) Terms and conditions.—Telecommunications services and network capacity provided to a public institutional telecommunications user under this subsection may not be sold, resold, or otherwise transferred by such user in consideration for money or any other thing of value.

(4) Eligibility of users.—No entity listed in this subsection shall be entitled to preferential rates or treatment as required by this subsection, if such entity operates as a for-profit business, is a school described in paragraph (5)(A) with an endowment of more than $50,000,000, or is a library not eligible for participation in State-based plans for funds under title III of the Library Services and Construction Act (20 USC 335c et seq.).

(5) Definitions.—For purposes of this subsection:

(A) Elementary and secondary schools.—The term "elementary and secondary schools" means elementary schools and secondary schools, as defined in paragraphs (14) and (25), respectively, of Section 14101 of the Elementary and Secondary Education Act of 1965 (20 USC 8801).

(B) Health care provider.—The term "health care provider" means—

(i) post-secondary educational institutions offering health care instruction, teaching hospitals, and medical schools;

(ii) community health centers or health centers providing health care to migrants;

(iii) local health departments or agencies;

(iv) community mental health centers;

(v) not-for-profit hospitals;

(vi) rural health clinics; and

(vii) consortia of health care providers consisting of one or more entities described in clauses (i) through (vi).

(C) Public institutional telecommunications user.—The term "public institutional telecommunications user" means an elementary or secondary school, a library, or a health care provider as those terms are defined in this paragraph.

(i) Consumer Protection.—The Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable.

(j) Lifeline Assistance.—Nothing in this section shall affect the collection, distribution, or administration of the Lifeline Assistance Program provided for by the Commission under regulations set forth in Section 69.117 of title 47, Code of Federal Regulations, and other related sections of such title.

(k) Subsidy of Competitive Services Prohibited.—A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, account-

ing safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

APPENDIX B

FROM *IN THE MATTER OF IMPLEMENTATION OF LOCAL COMPETITION PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996*, FIRST REPORT AND ORDER, CC DOCKET NO. 96-98 (AUG. 8, 1996):

¶¶ 263, 398, 414, 423

263. We disagree with those incumbent LECs which argue that features that are sold directly to end users as retail services, such as vertical features, cannot be considered elements within incumbent LEC networks.[564] If we were to conclude that any functionality sold directly to end users as a service, such as call forwarding or caller ID, cannot be defined as a network element, then incumbent LECs could provide local service to end users by selling them unbundled loops and switch elements, and thereby entirely evade the unbundling requirement in section 251(c)(3).[565] We are confident that Congress did not intend such a result. We further reject Ameritech's argument that we should not permit carriers to use unbundled elements to provide services that are priced above cost at retail. We agree with those parties that argue that competition will not develop if we find that supracompetitive pricing is protected by the 1996 Act.[566]

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398. The vast majority of commenters support the Commission's tentative conclusion that local switching

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[564] *See infra*, Section V.J, discussing vertical features and noting that the Illinois Commission has rejected arguments that vertical features cannot be incorporated into network elements.

[565] *See, e.g.*, CompTel reply at 20-22.

[566] *See, e.g.*, DoJ reply at 23-31; CompTel reply at 13-22. For a discussion of the argument that allowing new entrants to purchase vertical features as unbundled elements would nullify section 251(c)(4), *see infra*, Section V.H.

should be an unbundled network element.[865] Such parties note that the section 271 competitive checklist includes unbundled local switching and the legislative history of the 1996 Act identifies local switching as a possible element.[866] Several potential local competitors contend that unbundled local switching functionality is very important to promote entry into the local exchange market.[867]

* * * *

414. At this time we decline to require further unbundling of the local switch into a basic switching element and independent vertical feature elements. Such unbundling does not appear to be necessary to promote local competition. Indeed, most potential local competitors do not recommend that vertical switching features be available as separate network elements. MCI, AT&T and LDDS believe that such features should be available to new entrants as part of the local switching element.[921] We also note that additional unbundling of the local switching would not result in a practical difference in the way the local switching element is provisioned. As discussed below, when a competing provider orders the unbundled basic switching element for a particular customer line, it will designate which vertical features should be activated by the incumbent LEC for that line. In addition, the record indicates that the incremental costs associated with

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[865] *See, e.g.*, GCI comments at 12; TIA comments at 11-12; Citizens Utilities comments at 15; Intermedia comments at 13; Bay Springs, *et al.* comments at 18; Wyoming Commission comments at 22.

[866] *See, e.g.*, Ameritech comments at 43; LDDS comments at 44; USTA comments at 32; BellSouth comments at 40.

[867] LDDS reply at 18; TIA comments at 18; AT&T March 21 Letter 18 at 17-18; *but see* SBC reply at 23 ("Given that 'high margin' services are made possible through the switch, new entrants will likely purchase their own switching facilities.").

[921] AT&T June 28 *Ex Parte* at 1-2; MCI comments at 31; LDDS comments at 44.

vertical switching features on a per-line basis may be quite small,[922] and may not justify the administrative difficulty for the incumbent LEC or the arbitrator to determine a price for each vertical element. Thus, states can investigate, in arbitration or other proceedings, whether vertical switching features should be made available as separate network elements. We will continue to review and revise our rules in this area as necessary.

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423. We also disagree with the proposal to define local switching as a point of access plus basic switching functionality, but that would exclude vertical switching features.[946] As a legal matter, this definition is inconsistent with the 1996 Act's definition of "network element," which includes all the "features, functionalities, and capabilities provided by means of such facility or equipment."[947] In addition, this definition would not fulfill the procompetitive objectives of the 1996 Act as effectively as the per-line definition we adopt. A competitor that obtains basic and vertical switching features at cost-based rates will have maximum flexibility to distinguish its offerings from those of the incumbent LEC by developing a variety of service packages and pricing plans.[948] Moreover, an upfront purchase of all local switching features may speed entry by simplifying practical issues such as the pricing of individual switching features.

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[922] LDDS comments at 57, Letter from Bruce Cox, Government Affairs Director, AT&T, to Elliot Maxwell, FCC, June 25, 1996 (AT&T June 25 *Ex Parte*).

[946] Sprint comments at 34; USTA reply at 16-17; SBC reply at 20; NYNEX reply at 31; MECA comments at 29.

[947] 47 U.S.C. § 153(29); *see supra* section V.C., which interprets the Act's definition of "network element."

[948] *See, e.g.*, LDDS comments at 33; AT&T comments at 21.